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# CAUTIOUS CREDITOR®

## REVISED UCC ARTICLE 9: NEW RULES FOR DESCRIPTION OF COLLATERAL

Revised Article 9 of the Uniform Commercial Code will become law on July 1 in at least 28 states, including Indiana. Although Revised Article 9 maintains the general structure of secured transactions, the new article extensively changes familiar rules and procedures within that structure. This issue of the *Cautious Creditor*® addresses important changes to the rules for the description of the debtor's property to be used as collateral in a secured transaction under Revised Article 9.

As is true under current Article 9, improper description may result in loss of perfection or nullification of a security interest. Proper description of collateral is an essential element for the success of a secured transaction. Under Revised Article 9, improper description also may expose a creditor to debtor lawsuits.

### DESCRIPTION OF COLLATERAL IN SECURITY AGREEMENTS

The new rules for description of collateral are subtly different from existing law, depending on whether the description appears in a security agreement or in a financing statement. In a security agreement, the purpose of the collateral description is to unambiguously identify the property in which the secured party holds an interest. Revised Article 9 provides that a description is sufficient "if it reasonably identifies what is described." The new code gives some examples of satisfactory description methods, including the following:

- **SPECIFIC LISTING.** The most certain method is to specifically describe every item of collateral, often called the "serial number" approach. It can lead to voluminous attachments and is unworkable for "after acquired" collateral.
- **UCC COLLATERAL TYPE.** This method uses the familiar collateral types as defined in Revised Article 9, such as inventory, equipment, accounts and general intangibles. It is especially useful where the debtor grants a security interest in all of its

property of a type, such as "all of debtor's inventory."

- **CATEGORY.** "Category" is not defined in the UCC. It refers to any logical way of grouping or classifying collateral. Examples of this method are "all of debtor's personal computers" or "all of debtor's printing presses."

Almost any method used to describe collateral in a security agreement is satisfactory so long as it leaves no doubt as to what property is subject to the security interest. The sufficiency of any description may depend on the actual circumstances. The description "debtor's Acme Forklift" may be sufficient if the debtor owns only one such item. However if the debtor owns several such items, the description would be insufficient, and a court might rule that the secured party holds an interest in none of the forklifts.

One method of collateral description is unacceptable in a security agreement. Revised Article 9 specifically prohibits "supergeneric" collateral descriptions in security agreements. The statute provides that descriptions such as "all of the debtor's assets" or "all of debtor's personal property," or a description using words of similar import, does not reasonably describe the collateral. In transactions which actually do cover all of the debtor's assets, the security agreement must be drafted using one of the acceptable description methods in such a way as to include all debtor's property. One approach would be to list in the security agreement all collateral types defined in Revised Article 9.

### DESCRIPTION OF COLLATERAL IN FINANCING STATEMENTS

Collateral description in a financing statement serves a different purpose than in a security agreement. In a financing statement, the description is intended to put subsequent lenders on notice that a prior interest may exist in items of the debtor's property. Accordingly a description in a financing statement may be less

specific and still be effective even if it fails to unambiguously identify the specific collateral. For example, where a security agreement describes collateral as "debtor's 1999 Acme Forklift, Serial No. 13579," a sufficient description in the financing statement might directly repeat the description in the security agreement, or list "forklifts" or even "equipment."

Under Revised Article 9, the financing statement description may use any of the same methods which are acceptable for security agreements (specific listing, UCC type or category) and, in a departure from current Article 9, also may use supergeneric descriptions. In contrast to a security agreement, a valid financing statement may list collateral as "all of debtor's assets," or "all of debtor's personal property," or a description using words of similar import. However such supergeneric descriptions should be used only if the creditor is certain that the collateral descriptions in the security agreement really do comprise all assets of the debtor. These supergeneric descriptions may be a convenience and a time saver for creditors, but they should be used with great care, because they potentially expose creditors to new sanctions under Revised Article 9.

#### NONCOMPLIANCE SANCTIONS

Current Article 9 contains sanctions for noncompliance, but they apply only to violations of the default and foreclosure provisions of the code. Under Revised Article 9, the sanctions are broadened to apply to violations of any provision of Article 9 by a secured party. Specifically a debtor may sue a creditor for filing a financing statement which is unauthorized in whole or in part by the debtor. A debtor who prevails in such a suit may be awarded actual damages, plus statutory damages of \$500. A debtor may recover under this provision if the financing statement includes collateral which was not authorized to be listed. A violation might be as simple as a financing statement listing "accounts and inventory" where the security agreement listed only "inventory." A supergeneric description would also be a violation if the debtor owned any type or category of personal property which was not listed in the security agreement.

In order to avoid these sanctions, creditors should closely correlate descriptions in financing statements with descriptions in security agreements and should ensure that both descriptions are correct under the revised collateral type definitions in Revised Article 9. These definitions were addressed in a previous issue of the *Cautious Creditor*®.

#### COMMENT

Incorrect collateral descriptions in security agreements and financing statements can undermine a secured

transaction and even expose a creditor to sanctions. Creditors should ensure that the description in a security agreement unambiguously identifies the collateral. The description in a financing statement should name all of the types or categories of collateral without naming any items, types or categories which are not part of the transaction. Creditors also should ensure that they are using collateral types as modified in Revised Article 9.

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